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Navigating The FTC's Expanded Unfair-Competition Stance

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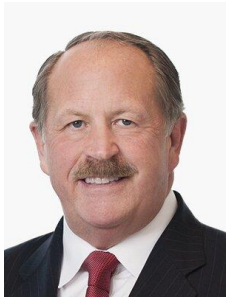

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On Nov. 10, the Federal Trade Commission voted to approve a new policy statement[1] interpreting the FTC's authority under Section 5 of the Federal Trade Commission Act, which prohibits "unfair methods of competition in or affecting commerce."

The commissioners voted 3-1, with Chair Lina Khan,[2] Commissioner Alvaro Bedoya[3] and Commissioner Rebecca Kelly Slaughter voting in favor and Commissioner Christine S. Wilson dissenting[4] in a party-line vote.

The newly **adopted** policy statement provides a significantly more expansive interpretation of the FTC's authority and replaces all prior FTC guidance on the scope and meaning of unfair methods of competition under Section 5.

The policy statement asserts that the FTC was set up to be an expert body charged with determining what constitutes unfair methods of competition and, accordingly, the FTC is entitled to great weight in its findings.

The Legal Framework

The policy statement provides a two-part framework for evaluating unfair methods of competition with minimal guardrails restraining the FTC's authority:[5]

- Conduct must be a method of competition undertaken by an actor in the marketplace and not just a condition of the marketplace that cannot be attributed to a specific actor; and

- The method of competition must be unfair, meaning that the conduct goes beyond competition on the merits. The FTC states that unfair competition is conduct that is "coercive, exploitative, collusive, abusive, deceptive, predatory or involves the use of economic power of a similar nature" and negatively affects competitive conditions.

This framework is to be applied on a sliding scale. If, for example, "the indicia of unfairness are clear, less

may be necessary to show a tendency to negatively affect competitive conditions," according to the statement.[6]

Where there is not facial unfairness, the FTC will take into account "the size, power, and purpose of the respondent" and the "current and potential future effects of the conduct."[7]

What Conduct Is Targeted?

The policy statement provides an open-ended interpretation of the FTC's authority to combat unfair methods of competition — using only adjectives to describe unfair methods. For this reason, the FTC offers examples of conduct that is an unfair method of competition that is not also covered by other antitrust laws.

The FTC buckets the examples into two types — enforcement actions for conduct (1) that constitutes an incipient violation of the antitrust laws or (2) that violates the spirit of the antitrust laws.[8]

Based on this language, the FTC may bring enforcement actions under Section 5 to correct conduct that may not fall within the literal language of the antitrust laws.

Incipient violations are acts by those who have not yet gained monopoly power or market power or that engage in conduct that has the tendency to result in violations of the antitrust laws. Examples shared by FTC of such problematic conduct include:

- Invitations to collude;
- A series of acquisitions that individually were not problematic but in total have brought about the harms the antitrust laws seek to prevent; and
- Loyalty rebates, tying, bundling and exclusive dealing arrangements that "have the tendency to ripen" into violations of the antitrust laws because of industry conditions and the position of the acting party in that industry.

Conduct that violates the spirit of the antitrust laws under Section 5 includes, according to the FTC, conduct that may not fall within the literal language of the antitrust laws but is an unfair method just the same. A few of the examples such problematic conduct in the policy statement include:

- Parallel exclusionary conduct;
- Practices that facilitate tacit coordination;
- Utilizing technological incompatibilities to negatively impact competition in adjacent markets;
- Price discrimination such as knowingly inducing and receiving disproportionate promotional allowances against buyers not covered by Clayton Act;
- De facto tying, bundling, exclusive dealing or loyalty rebates that use market power in one market to entrench that power or impede competition in the same or a related market;

- Fraudulent and inequitable practices that undermine the standard-setting process or that interfere with the Patent Office's full examination of patent applications;

- Interlocking directors and officers of competing firms not covered by the literal language of the Clayton Act;

- False or deceptive advertising or marketing which tends to create or maintain market power; or

- Acquisitions of a potential or nascent competitor that tends to lessen current or future competition.

Importantly, many of these proposed unfair methods of competition align with recently stated enforcement priorities of the FTC and the U.S. Department of Justice targeting private equity deals, the pharmaceutical industry, and M&A generally.

The enforcers have repeatedly stated their concerns in interviews, press releases and formal actions with:

- Roll-up or serial acquisitions[9] in the private equity space;

- Firms appointing officers and directors to the boards of competitors;[10]

- The pharmacy industry allegedly using rebates as a form of commercial bribery;[11] and

- So-called killer acquisitions of nascent competitors.[12]

Explicitly enumerating the three merger-related harms makes clear the policy statement is intended, in part, to fill perceived enforcement gaps in the M&A space not currently accounted for under the Clayton Act.

Applicability Issues

The FTC will apply a "quasi-per se quick look" analysis to Section 5 cases rather than the rule of reason analysis required for most claims under the Sherman and Clayton Acts, according to the statement.

The policy statement provides that an inquiry into conduct will not focus on the rule of reason and instead will focus on the anticipated effects of the conduct on consumers, labor, competitive rivals, and others.[13]

Wilson's dissent insists that this approach approximates per se condemnation.[14]

Applying per se treatment eliminates any opportunity for a defendant to rebut or justify its conduct and instead liability attaches once the alleged unfair conduct is shown to have occurred.[15]

Traditionally, per se treatment was reserved for conduct such as price fixing, market allocation, and group boycotts — conduct that is a "naked restraint of trade with no purpose except stifling of competition."[16]

Applying a "quasi-per se quick look" analysis to conduct such as loyalty rebate programs, tying, bundling, or exclusive dealing would ignore legitimate business rationales and pro-competitive benefits.

No Actual Harm Need Be Shown

The new interpretation states that the inquiry turns not on "whether the conduct directly caused actual harm in the specific instance at issue" but rather turns on "whether the respondent's conduct has a tendency to generate negative consequences such as raising prices, reducing output, limiting choice, lowering quality, reducing innovation, impairing other market participants, or reducing the likelihood of potential or nascent competition."[17]

The policy statement indicates that while actual harm may not be present, enforcement actions can be predicated on evaluations of conduct "in the aggregate along with the conduct of others engaging in the same or similar conduct."[18]

Based on this interpretation, it is possible that the FTC will bring actions against conduct that has previously not given rise to liability.[19]

No Market Need Be Defined or Market Power Shown

The policy statement indicates that "Section 5 does not require a separate showing of market power or market definition when the evidence indicates that such conduct tends to negatively affect competitive conditions."[20]

Removing the requirement to show market power or define a relevant market eliminates a significant hurdle for the FTC that can often be determinative to the outcome of a case, for example, in a tying case the government typically must show that the defendant has market power in the tying market such that the firm can restrain trade in the tied market.[21]

Given the recent defeats suffered by the enforcement agencies on the merger front, particularly resulting from a failure to properly define markets, it is not surprising that the FTC would interpret Section 5 in such a way as to remove this impediment.[22]

Anticipated Judicial Response

Courts have long accepted the FTC's authority to uphold the spirit and policy of the Sherman, Clayton and Robinson-Patman Acts through the enforcement of Section 5.[23]

However, courts have required that the FTC show the conduct at issue is harmful to competition and there have been a number of instances where the FTC has lost Section 5 cases for failing to show that the business practices had a harmful effect on competition.[24] With the issuance of this policy statement, the FTC has attempted to dispense with this requirement.

Despite the position taken in the policy statement, the FTC will likely still have to meet the standard of showing harm to competition if they are to prevail at trial. It is unlikely a court will accept the FTC's newly proposed standard of a "tendency to generate negative consequences" given the historical posture of the appellate courts.

Based on this expectation, defendants will likely have the opportunity to provide evidence of a legitimate business reason or pro-competitive justification for their alleged unfair conduct.

Takeaways

It is difficult to predict how this policy statement will be applied in practice given the vagueness and lack of clear boundaries articulated.

Khan states that the policy statement includes guardrails based on the definitions of "methods of competition," "unfair" and the "tendency to harm competitive conditions."

Khan also states that the policy statement "does not neatly set out a bounded list of prohibited practices."[25] As stated in Wilson's dissent, the policy statement "adopts an expansive 'I know it when I see it' approach."[26]

Uncertainty abounds with how these policies will be applied.

In historical context, this policy statement, proposing size and strength of a firm as key enforcement considerations, is a significant departure from the current consumer welfare standard,[27] which evaluates conduct based on negative impact to price, choice and quality for consumers.

Footnote 15 to the policy statement cites Section 5 legislative history stating that Section 5 was intended to protect "smaller, weaker business organizations."[28] This language is a strong signal of a desire to return to the structural framework applied by enforcers from the 1940s to the 1970s.

Similar to past guidance from the enforcement agencies during the Biden administration, it remains to be seen if these policies will gain traction in court where decades of antitrust jurisprudence oppose this type of legal approach.

As such, parties that are willing to litigate Section 5 enforcement actions have a good opportunity to attain a favorable outcome in court. For this reason, we advise that clients should:

- Clearly document the pro-competitive benefits for business decisions that could be perceived to be similar to the historical examples set out by FTC.

- Be mindful of how conduct could be perceived by others in the industry and if sentiment is anticipated to be negative consider how to rebut those potential concerns.

- Consider conducting retrospectives that demonstrate the vitality of competition, threats to sales gains and other considerations that reflect a vibrant competition and supply ecosystem in any areas in which the business is considered a significant competitor.

Most importantly, firms must continue to educate themselves of the changes in this aggressive enforcement environment and remain vigilant of conduct that may fall within the enumerated list of prohibited conduct provided in the policy statement. Going forward, it will become more critical to evaluate past, existing, and future practices for Section 5 liability.

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[1] https://www.ftc.gov/system/files/ftc_gov/pdf/P221202Section5PolicyStatement.pdf.

[2] https://www.ftc.gov/system/files/ftc_gov/pdf/Section5PolicyStmtKhanSlaughterBedoyaStmt.pdf.

[3] https://www.ftc.gov/system/files/ftc_gov/pdf/P221202Section5PolicyStmtBedoyaStmt.pdf.

[4] https://www.ftc.gov/system/files/ftc_gov/pdf/P221202Section5PolicyWilsonDissentStmt.pdf.

[5] Federal Trade Commission, Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act, 8 (Nov. 10, 2022) [hereinafter "Nov. 10 Policy Statement"]; see also Statement of Chair Lina Khan Regarding the "Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section5 of the Federal Trade Commission Act", at 4, 5 (Nov. 10, 2022) [hereinafter "Khan Statement."].

[6] Id. at 9.

[7] Id. at 9.

[8] Id. at 12.

[9] https://www.ft.com/content/ef9e4ce8-ab9a-45b3-ad91-7877f0e1c797.

[10] https://www.justice.gov/opa/pr/directors-resign-boards-five-companies-response-justice-department-concerns-about-potentially.

[11] https://www.ftc.gov/system/files/ftc_gov/pdf/Policy%20Statement%20of%20the%20Federal%20Trade%20Commission%20on%20Rebates%20and%20Fees%20in%20Exchange%20for%20Excluding%20Lower-Cost%20Drug%20Products.near%20final.pdf.

[12] https://www.ftc.gov/system/files/documents/public_statements/1596396/statement_of_chair_lina_m_khan_commissioner_rohit_chopra_and_commissioner_rebecca_kelly_slaughter_on.pdf.

[13] Nov. 10 Policy Statement at 10.

[14] Wilson Statement at 6.

[15] Antitrust Law Developments at 1B-3-a.

[16] Id.

[17] Id. at 10.

[18] Id. at 10.

[19] Dissenting Statement of Commissioner Christine Wilson on the Policy Statement Regarding the

Scope of Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act (Nov. 10, 2022) [hereinafter "Wilson Statement."] (stating that "the Commission's invocation of nefarious-sounding adjectives and conclusory assertions of 'tendency' for harm will trump sometimes substantial judicial experience regarding the likelihood of competitive harm."); Khan Statement at 2 (explaining that "[t]he Supreme Court has repeatedly made clear that Section 5 does not apply only to practices that violate the Sherman Act or other antitrust laws. Through the late 1970s, the FTC frequently brought Section 5 cases against conduct that would not necessarily run afoul of the Sherman Act.").

[20] Id. at 10.

[21] Antitrust Law Developments (9th ed. 2022) at 2C-2-c.

[22] United States v. Booz Allen Hamilton, Inc., et al., 2022 U.S. Dist LEXIS 190006 at 13, 14 (D. Md. Oct. 11, 2022) (determining that the government did not sufficiently define a relevant market thus any allegations about Booz Allen's market power fail.).

[23] FTC v. Indiana Federation of Dentists, 476 U.S. 447, 454 (1986) (stating that "[t]he standard of 'fairness' under the FTC Act is, by necessity, an elusive one, encompassing not only practices that violate the Sherman Act and other antitrust laws, but also practices that the Commission determines are against public policy for other reasons…").

[24] See Boise Cascade v. FTC, 637 F.2d 573 (9th Cir. 1980) (holding that the FTC failed to prove either collusion or actual effect on competition to support a Section 5 violation where the parties agreed that the practice at issue was a natural and competitive development in the industry lacking any evidence of an overt conspiracy); and E.I. duPont de Nemours & Co. ("Ethyl") v. FTC, 729 F.2d 128 (2d Cir. 1984) (rejecting FTC's action against price signaling practices competitors in the industry learned of each other's pricing in the normal course and most significant competition within the industry was based on non-price terms, meaning the non-collusive business practices at issue did not have the effect of lessening competition).

[25] Khan Statement at 4, 5.

[26] Wilson Statement at 17.

[27] Id. at 4 (indicating that "while courts have applied the rule of reason and consumer welfare standards in the context of the Sherman Act, there is no basis in precedent for applying them wholesale to standalone Section 5.").

[28] Nov. 10 Policy Statement, fn. 15 at 3; see also Statement of Commissioner Alvaro Bedoya on the Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act (Nov. 10, 2022) [hereinafter "Bedoya Statement."] (asserting that "…the FTC will have the role of 'policing competition so as to protect small business men, keep an open field for new enterprise, and prevent the development of trusts.'") (quoting Memorandum from George Rublee for President Woodrow Wilson Concerning Section 5 of the Bill to Create a Federal Trade Commission 3 (July 10, 1914)(unpublished memorandum)(on file with the FTC).